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UNCLAS CAIRO 001863

SENSITIVE  
SIPDIS

DEPT FOR NEA/ELA  
TREASURY FOR BEN DENNIS AND CHARLES MORAVEC  
COMMERCE FOR TOM SAMS AND NATE MASON

E.O. 12958: N/A  
TAGS: [ECON](#) [EAID](#) [EFIN](#) [EINV](#) [EG](#)  
SUBJECT: EGYPTIAN SUBSIDIES HIT THE FISCAL BOTTOM LINE HARD

REF: 08 CAIRO 587

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Summary:  
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¶1. (U) Recent data released by the GOE on spending during fiscal year 2007-8 (July-June) highlight the impact of inflation and the rising cost of government subsidies on the GOE budget. Sharp increases in revenue due to economic growth and tax increases were offset by a 25% increase in public spending. The cost of fuel and food subsidies has risen dramatically and continues to feed high budget deficits. GOE officials are cautiously optimistic that inflation will subside somewhat in the coming year, but admit that the GOE fiscal deficit remains an obstacle to long-term economic stability. End Summary.

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Up, Up, and Away  
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¶2. (U) Preliminary budget results for the 2007-2008 fiscal year (July-June) highlight the severe impact on the Egyptian budget of increasing global commodity prices as well as the cost of GOE responses to threats to "public stability." Overall public spending climbed to LE 277.4 billion (\$52.3 bn) -- an increase of 25% over the prior year and slightly above the LE 273.6 billion (\$51.6 bn) previously projected by the IMF. Increases in taxes to offset government wage hikes, along with government revenue increases driven by continued strong growth in the economy, aided a small decline the GOE fiscal deficit from 7.5% of GDP in 2006-7 to 6.8% of GDP in 2007-8. The GOE reported that tax revenues grew by 20.2% y/y and non-tax revenues climbed by 23.1%.

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Subsidy Costs Explode  
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¶3. (U) The cost of GOE subsidies in 2007-8, primarily for food and energy, grew by 56% compared to the prior year, reaching LE 84.2 billion (\$15.9 bn) including LE 60.3 billion (\$11.4 bn) for fuel and LE 16.5 billion (\$3.1 bn) for food. These subsidies account for 30% of total public spending. This level of spending leaves little room for expenditures in other vitally important areas, despite rising need. As an example, in 2007-8 the GOE spent only LE 32.9 billion (\$6.1 bn) on education and LE 12.7 billion (\$2.4 bn) on public health -- when combined still 25% less than what the GOE spent on the fuel subsidy alone.

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Inflation Remains a Concern

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¶4. (U) Inflation continues to be high. In July, inflation accelerated to 22.2% y/y (vs. a June figure of 20.2% y/y) with food inflation hitting nearly 29.9% y/y according to statistics released by the Central Agency for Public Mobilization and Statistics (CAPMAS). Continuing inflationary pressure led the Central Bank, on August 7, to raise overnight deposit and lending rates by 50 basis points to 11 and 13% respectively.

¶5. (SBU) Hany Kadry Dimian, Deputy Minister and Director of the Macro-Fiscal Unit of the Ministry of Finance told Econoff that he felt that the Egyptian economy had almost fully digested the wage hikes and the rise in commodity prices, and inflation had peaked. He expected average inflation to drop to the 9-10% range in the 2008-2009 fiscal year. This view was echoed by the Hisham Ramez, Deputy Governor of the Central Bank, in a meeting August 20. Ramez commented that he felt inflation would return to more "normal" levels (somewhere below 8%) over the next 12 months, albeit from a much higher base. Ramez also emphasized the importance of lowering the fiscal deficit.

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Comment  
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¶6. (SBU) The GOE is very conscious of the public sensitivity to any changes in the prices of subsidized commodities, particularly food. Shortages of subsidized bread resulting in long bread lines and heightened public anxiety about bread prices have prompted President Mubarak to involve the military in baking and bread distribution (reftel). Recent drops in commodity prices, if sustained, may alleviate some near-term fiscal pressure; however, the subsidy regime remains a long term constraint on the GOE budget. To reach the planned reduction in the fiscal deficit to 3% of GDP by 2011, significant spending reforms are unavoidable. Additionally, reforming the subsidy system in a country that has long resisted such change will require courage, leadership, and a public relations acumen that the GOE frequently lacks.  
SCOBAY